What is clear is that applying the CC/BC *and* eliminating the FLC would *significantly* understate Verizon VA's costs. As explained below, the CC/BC will on average produce lower ACFs by increasing the investment denominator, and as explained above, in the absence of an FLC-type factor, the application of these reduced ACFs to TELRIC investments will produce even *lower* expenses, with no rationale whatsoever. The chart below aptly summarizes the distinction between the CC/BC ratio and the FLC factor:

Factor	Starting Point	Ending Point
CC/BC	Booked investment at time of purchase for equipmernt and facilities, reflecting embedded network architecture.	Current investment for embedded equipment and facilities, reflecting embedded network architecture.
FLC	Booked investment at time of purchase for equipment and facilities, reflecting embedded network architecture.	Forward-looking investment for current equipment and facilities, reflecting forward-looking network architecture.

(*i.e.*, the ACF for the embedded investment) is \$1 million/\$10 million = 10%. The $ACF_{current}$ (*i.e.*, the ACF for embedded investment adjusted for current dollars) equals \$1 million/[\$10 million x CC/BC ratio of 1.35] = 7.4074%. What AT&T/WorldCom fail to do is state the cost factors in *forward-looking* terms. The $ACF_{forward\text{-}looking}$ equals $ACF_{current}/FLC_{adj}$ = 7.4074%/59.3%= 12.5%. To reach this result, the $ACF_{embedded}$ must be converted to the $ACF_{current}$, and the FLC_{calc} must be converted to the FLC_{adj}. Verizon VA's approach allows calculation of the $ACF_{forward\text{-}looking}$ in a single step: $ACF_{forward\text{-}looking}$ equals $ACF_{embedded}/FLC_{calc}$ = 10%/80% = 12.5%. Both Verizon VA's method and AT&T/WorldCom's method (once corrected to reflect the forward-looking network) yield the same result in this example -- 12.5%. But Verizon VA's approach is far simpler.

Q. Explain why applying the CC/BC ratio to the investment denominator will understate costs.

A. CC/BC ratios are generally greater than one. In Virginia, for example, the average CC/BC ratio is 1.385.[27] (In fact, there are different CC/BC's for each class of plant.) As noted above, since the CC/BC ratio is applied to the denominator in the ACF calculations,[28] the impact of AT&T/WorldCom's methodology using this Virginia average CC/BC would be to reduce the expense ACFs to approximately 72% of their original values. If forward-looking TELRIC investments are determined by this Commission to be, for example, 70% of the embedded investments, the application of the CC/BC adjusted ACFs to this TELRIC investment in the absence of an FLC-equivalent would identify only approximately half of the actual expenses Verizon VA likely would incur. This overwhelming reduction would not be based on any grounded or defensible cost reduction expectations; it is simply a mathematical sleight of hand.

Q. Should the Commission adopt AT&T/WorldCom's proposed application of the CC/BC ratio?

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[27] *See* Verizon VA Response to AT&T/WorldCom Data Request 6-11. (Attachment A.)

[28] The ACFs would be calculated as [Expenses]/[Embedded Investments x "CC/BC" Ratios].

A. No. AT&T/WorldCom's proposed use of the CC/BC ratio is designed to understate Verizon VA's expenses. Verizon's FLC factor, on the other hand, is a more reasonable means of both accounting for changes in investment levels and preparing a TELRIC UNE study.

C. VERIZON VA'S FORWARD-LOOKING REDUCTION IN COPPER CABLE REPAIR EXPENSES IS APPROPRIATE AND REALISTIC

Q. Please explain how Verizon VA treats cable repair and maintenance expenses in the forward-looking environment.

A. Verizon VA has estimated that the use of newer copper plant will cause repair expenses to decline by 5%.

Q. After suggesting that Verizon VA does not adjust its expenses to be forward-looking, AT&T/WorldCom acknowledge that Verizon in fact assumes a 5% reduction in cable repair expenses — but they then argue that this should be increased to a 30% reduction, which should be applied to both repair ("R") and maintenance ("M"). [AT&T/WorldCom Rebuttal Panel at 88-89.] Please explain why this is incorrect.

A. Although AT&T/WorldCom suggest that Verizon VA's estimate of a 5% reduction is unsupported, it is, to the contrary, and as explained in the Verizon Panel Direct, based on the experience of its engineers and their very conservative assumptions concerning future maintenance developments.[29/] In contrast, the proposed reduction in the AT&T/WorldCom Rebuttal Panel testimony is based on a complete misreading (or misrepresentation) of some Verizon Maryland documents, and AT&T/WorldCom do not even *attempt* to support their assumption by reference to any real world network experience to which any of their witnesses might attest.

Specifically, AT&T/WorldCom claim that their 30% estimate is based on Verizon Maryland documents indicating that the company "anticipate[s] achieving a 90% reduction in maintenance expenses when [it] rehabilitate[s] areas of plant." [30/] But the documents on which AT&T/WorldCom purport to rely show no such thing.

The Verizon Maryland "rehabilitation" documents are designed to prioritize, under budgeting constraints, among DAs to be scheduled for rehabilitation by determining which DAs will produce the most return for

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[29/] *See* Verizon VA Supplemental Response to AT&T/WorldCom Data Request 1-5 (quoting email correspondence from John L. White, Executive Director, Outside Plant Technology and Standards, to Gary E. Sanford (Aug. 8, 1998), to the effect that "[a]ny outside plant (hardware) built to the latest design standards will perform with a 5% lower breakage (maintenance) over its lifetime, than the typical plant we have in our embedded base, assuming all other factors are kept constant. I make this assessment based on the use of latest materials, designs and application guidelines for cable, terminals and wire"). This response is included as Attachment A.

[30/] AT&T/WorldCom Rebuttal Panel at 91.

the investment dollar when rehabilitated with new copper.[31] There are several variables involved in such an analysis: for example, the number of trouble reports (Code 4s) in a given DA, the amount of investment that would be necessary to rehabilitate the plant, and the pace and amount by which line growth in the DA is proceeding. To enable a standardized comparison of rehabilitation benefits across DAs, Verizon uses a formula that assumes certain default values to use in its formula. The NETCAM software model designed to perform the rough economic analysis used for the rehabilitation study generates a default figure for the reduction in maintenance and repair costs — in this case, the 90% on which AT&T/WorldCom erroneously seize. The model uses these default and variable values to determine the benefit of performing the rehabilitation measured in terms of the net present value of the rehabilitation and the discounted payback period.

Thus, there is simply no truth to the allegation that Verizon — either in Maryland, Virginia, or elsewhere — ever assumes, much less experiences, a 90% reduction in repair and maintenance expenses as a result of rehabilitation. We note, as an aside, that even if the 90% were assumed to reflect a true, expected reduction in maintenance expenses, such a 90% figure would reflect the improvements expected only in the

[31] *See, e.g.* the Verizon Maryland Outside Plant Estimate Case 3282, Attachment D.

particular DA at issue (and, of course, would relate only to the first year after installation). Where there are more Code 4s, and the plant is performing significantly below expectations, it is possible that following rehabilitation, a significant improvement might be noted with respect to maintenance in that particular DA. Indeed, the Code 4 rate for the DAs reflected on the Verizon Maryland documents cited by AT&T/WorldCom show rates greater than 2.0, while the Code 4 rate for Virginia as a whole is approximately 0.67. Thus, even if *any* reduction actually were assumed with respect to the DAs referenced by AT&T/WorldCom, there would be absolutely no basis on which to generalize from that figure across the Virginia network.

Moreover, AT&T/WorldCom's effort to apply their proposed 30% reduction to maintenance expenses ("M" dollars) in addition to repair makes no sense whatsoever. The "maintenance expenses" included in the network ACFs do not relate to fixing or maintaining "broken" or "defective" plant. Rather, "M" dollars relate to "Moves and Rearrangements" of plant, activities that do not correlate in any manner with clearing trouble conditions, and which thus will not be reduced as a result of the substitution of new copper for older copper. "Maintenance" activities (for example, pumping out manholes, relabeling the pair identifications on a distribution terminal, or raising or lowering an existing cable around an obstruction) are quite often caused by the movement of customers, municipal requirements, and other necessary network changes. There is simply no basis to assume (nor would it be appropriate to do so) that any level of reduction in these types of expenses (much less the 30% proposed by AT&T/WorldCom) is possible simply as a result of the use of the use of the latest cable materials or designs.

Q. But AT&T/WorldCom claim that Verizon VA experiences high cable maintenance and repair costs (and high Code 4 rates) at least in part because Verizon allegedly clears trouble reports through a line and station transfer. [AT&T/WorldCom Rebuttal Panel at 89.] Please respond.

A. First, AT&T/WorldCom appear to confuse "line and station transfers" (LSTs) with "pair transfers." An LST usually refers to the transfer of a working pair in order to free up a good pair to use on installation, whereas a pair transfer refers to the movement off a defective pair onto a good pair in order to restore service. Regardless, AT&T/WorldCom are simply wrong when they claim that Verizon VA typically clears trouble reports through such a method, notwithstanding the alleged results of an operational review that Mr. Riolo performed 23 years ago, or his assertion that NYNEX used this method until 1992.[32] Indeed, Verizon VA's trouble report data indicates that in 1999, fewer than 28% of Code 4's were addressed using this method of outside plant transfer ("040's"). This

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[32] AT&T/WorldCom's Response to VZ-VA 13-23. (Attachment A.)

small percentage clearly is not "typical," given that over 70% of outside plant troubles are cleared using other methods, and AT&T/WorldCom's effort to suggest that Verizon VA has an unusually high level of repair expenses due to less-than-optimal repair methodologies is thus simply wrong.

Q. What assumption should the Commission accordingly make with respect to forward-looking repair and maintenance expenses in connection with copper cables?

A. The Commission should adopt Verizon VA's 5% reduction estimate; AT&T/WorldCom's 30% reduction is based on entirely unrealistic and unsubstantiated assumptions.

D. AT&T/WORLDCOM'S PROPOSED EXCLUSION OF "Y2K EXPENSES" MAKES NO SENSE AND IS UNFOUNDED

Q. AT&T/WorldCom claim that "Y2K"-related expenditures should be removed from the ACFs. Does this make sense?

A. No. There really is no unique category of "Y2K" expenses; there is simply the annual Information Systems ("IS") budget, which, in 1999, was spent in significant part on Y2K activities. In other words, when Y2K projects became a priority, the company committed a major portion of its allotted IS budget to Y2K work. As a result, other IS work, such as technology trials, expense reduction projects, and new product development/introduction had to be delayed or postponed. Thus, the IS budget was not *expanded* to accommodate Y2K work; rather, in 1999, the IS budget was largely allotted to such work. Nor is there anything to the argument that the 1999 IS budget was simply increased to accommodate Y2K needs. If that were the case, one would expect 2000 IS expenses to be significantly lower than the 1999 expenses that AT&T/WorldCom question. In fact, however, ARMIS data show the 2000 level of IS expenses in Virginia to be more than 10% higher than in 1999. It accordingly would be inappropriate to reduce Verizon's costs to adjust for any Y2K expenses, since those expenses did not reflect a one-time increase in costs but were simply part of ongoing and standard IS expenses.

Q. So should the Commission adopt AT&T/WorldCom's proposal to disregard Y2K expenses?

A. No. As explained, such expenses are nothing more than the 1999 IS budget. There is no reasonable basis to exclude them.

E. VERIZON VA'S WHOLESALE MARKETING EXPENSE FACTOR IS CONSISTENT WITH THE FORWARD-LOOKING MARKETPLACE

Q. AT&T/WorldCom states that all of Verizon VA's advertising costs should be considered retail avoided cost, and thus should be removed from wholesale prices. [AT&T/WorldCom Rebuttal Panel at 93.] Do you agree?

A. No. The task at hand is to estimate the forward-looking costs of providing UNEs in a forward-looking network in the forward-looking *marketplace* that the Telecommunications Act of 1996 was designed to create. If costs are projected forward, then other assumptions should also be forward-looking, including assumptions concerning the marketplace in which Verizon will be using its forward-looking network to provide services to its customers and its competitors. In this type of marketplace, there should be significantly increased competition arising from, for example, other facilities-based providers and providers of alternative network components. That market would likely resemble the wireless market, in which there is both retail and wholesale advertising, as discussed below, and thus advertising, and the associated costs, is an appropriate feature of the wholesale market.

Q. In such a marketplace, what kinds of advertising would there be?

A. In arguing that Verizon VA seeks to recover its *retail* advertising expenses, AT&T/WorldCom obviously contend that retail advertising is the only advertising in which Verizon VA would engage. But this is a short-sighted view based on *today's* local wireline service marketplace — one of the few times, in fact, that AT&T/WorldCom refuse to be aggressively forward-looking! Indeed, in a forward-looking market, it is reasonable to expect that Verizon VA would engage in several distinct types of advertising in addition to plain retail customer advertising. These types include general market stimulation advertising, brand awareness advertising, and advertising to CLECs.

Q. What is general market stimulation advertising?

A. This is an important type of advertising, pervasive throughout many industries, that benefits both the wholesale provider and its retail provider customers. Market stimulation advertising is designed to encourage customers to buy more of a product or, as in the case of telecommunications, a service. It is thus advantageous for both the wholesale and the retail providers, because successful market stimulation advertising will result in more revenue-generating usage being pumped across the network — benefiting the retail provider by producing more retail sales and the wholesale provider by generating more sales to the retailers. This form of advertising generates direct retail revenues and indirect wholesale revenues.

In Verizon VA's case, market stimulation advertising might take the form of promoting certain telecommunications services — for example, call waiting or three-way calling. Such advertising could be generic, or might be designed to promote *Verizon's* three-way calling service. But the overall result would still be to educate consumers about and interest them in the particular service at issue — with the result that consumers will begin requesting that service from their provider, be it Verizon or a CLEC.

It is not unusual for wholesalers to engage in market stimulation campaigns that may even be brand-neutral. Famous ad campaigns such as "Got Milk," "Pork — The Other White Meat," "Diamonds are Forever," "Beef: It's Real Food for Real People" and many others were all market stimulation campaigns developed by wholesalers, manufacturers or industry councils — not retailers — to promote the use of their respective products. But of course, the retailers ultimately selling those products would benefit as well.

Q. Please explain brand awareness advertising and why Verizon VA would engage in such advertising in the forward-looking marketplace.

A. Brand awareness marketing can stimulate end user customer demand for retail products that bear the wholesale product's brand. For example, Intel, with its "Intel Inside" campaign, hopes to induce retail customers to demand computers that include Intel chips. Intel, of course, does not sell chips directly to end users; the chips are incorporated as a component in the computers that Intel's customers — retail computer suppliers — offer to the end users. The goal of developing such brand awareness is to make a computer with an Intel chip more attractive and competitive for consumers than one without an Intel chip. The goal of an analogous

"Verizon Inside" brand awareness campaign would be to convince consumers to seek out CLECs whose service offerings make use of Verizon's network rather than that of an alternative provider. Brand awareness advertising already exists in the telecommunications market. For example, Lucent has used the advertising slogan, "We make the things that make communications work."™

While in today's marketplace, a "Verizon Inside" campaign may seem far-fetched, in a forward-looking marketplace, if the facilities-based competition envisioned by Congress develops, consumers will have a choice among several different networks, and Verizon may have to undertake efforts to capture market share both through direct retail sales and through encouraging consumers to begin comparing CLEC offerings based on the reliability of underlying network components; CLECs likely would in turn respond (at that point, likely with Verizon's encouragement) to such market pressure by making such information available to attract consumers.[33/]

[33/] Similarly, Michelin, a wholesale and retail tire manufacturer, advertises its products using a safety theme, among others. While that advertising will stimulate outright purchases of the tires, it also makes new vehicles that feature Michelin tires more attractive to purchasers than automobiles using lesser-known brands. (As a result, the Ford Motor Company has begun advertising its use of Michelin tires, to alleviate its recent public relations problems relating to Firestone tires.) *See, e.g.*, Justin Hyde, "Ford, Firestone Go on the Offensive Over Recall," at http://www.legalnewsnet.com/publications /JH20010523.html (last accessed Sept. 17, 2001).

Q. Why would Verizon VA engage in advertising directed to the CLECs themselves?

A. In the anticipated forward-looking market, Verizon VA would have to advertise its wholesale service and UNEs to compete with other providers of similar and substitute facilities. The fact that Verizon may be a dominant provider of UNEs today does not mean that this position is assured or that Verizon would not advertise in an effort to protect its wholesale market share. AT&T has been the dominant long distance provider for years, but when Sprint and MCI began competing, it clearly engaged in advertising to retain its market share. Alternative facilities providers can be expected to advertise in order to become carriers' carriers, and Verizon will need to respond in order to protect its wholesale market share. Already, in fact, alternative providers of network facilities and services have begun marketing aggressively in industry trade journals. For example, Williams Network has been advertising its network in carrier-focused ads. CapRock, a facilities-based provider, advertises its fiber optic network to other carriers. SNET has been advertising its SS7 Signaling Network, an unbundled network element. Net2Phone has been marketing to other providers a Voice over Internet Protocol (VoIP) alternative to local network usage. Access Line has been advertising a suite of hosted voice services. Pathnet has promoted Data, Voice, Video, Internet and IP PBX Connectivity through ads that state, "Our customers aren't end users — They're service providers like you." GTE Network

Services advertised carrier transport. Point One markets its digital network for voice, video and data to other carriers. And, Verizon itself has undertaken wholesale advertising in the competitive wireless marketplace.[34] Such advertising should increase in the future as the marketplace evolves, and competitive alternatives proliferate. Verizon, like these other facilities providers, will have an incentive (and indeed a need) to advertise as well.

Q. Is it therefore reasonable to assume that Verizon VA's advertising budget in the forward-looking marketplace is a genuine wholesale business need and should not be discounted significantly or entirely on the theory that it is retail-avoided?

A. Yes. Although today the bulk of Verizon VA's advertising budget is spent on retail advertising, the advertising dollars will increasingly go toward wholesale advertising as the market develops and becomes more competitive. The Commission should thus reject AT&T/WorldCom's position.

F. AT&T/WORLDCOM'S ARGUMENT CONCERNING INCLUSION OF "MERGER SAVINGS" IS FLAWED AND UNSUPPORTED

Q. AT&T/WorldCom charge that Verizon VA's costs should be reduced because Verizon did not reflect anticipated savings from either of the

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[34] *See* Attachment E for selected examples of such ads.

Bell Atlantic/NYNEX or Verizon/GTE mergers. Should Verizon's costs be adjusted as they suggest? [AT&T/WorldCom Rebuttal Panel at 87.]

A. No. While, as AT&T/WorldCom note, Verizon has projected savings and capital synergies from the Bell Atlantic/GTE and Bell Atlantic/NYNEX mergers, the actual amount of savings that ultimately will be realized remains subject to significant uncertainties. Those projections thus should not be included at this time in the cost studies at issue in these proceedings. Moreover, the projected savings encompassed a large number of functions unrelated to Verizon's wholesale business, including the migration of long-distance traffic onto GTE's network, greater efficiency in wireless operations, and volume purchasing and the elimination of certain capital costs associated with building a data network. Thus, many of the savings should be enjoyed by separate affiliates within the Verizon family, and not by the local service provider companies.

Finally, merger savings represent the increase in efficiency and productivity that should be experienced when an activity can be centralized in one office rather than duplicated by both merger partners. The activity does not necessarily cost less to perform, but it is only being performed once. Thus, Verizon VA's costs to perform a specific activity are not necessarily any lower than they were prior to the merger. To the extent, however, that Verizon VA should experience increased productivity overall as a result of the mergers, this increase should be accounted for in the productivity improvements reflected in Verizon's cost studies. Unless AT&T/WorldCom have some basis for alleging that the productivity adjustments are not sufficient to reflect such savings — and they have alleged none whatsoever — and until they can demonstrate some reason to conclude that such savings would be experienced by Verizon VA as opposed to the non-ILEC affiliates, there is no defensible basis for reducing the identified expenses even further.

Q. AT&T/WorldCom suggest a 2.6% reduction in Verizon's joint and common overhead cost factor, based on Verizon workpapers regarding merger savings filed in the New York proceedings. [AT&T/WorldCom Rebuttal Panel at 88.] Should this reduction be included here?

A. No. First, the New York filing was based on 1998 data, not 1999 data as used here. As of 1998, Verizon had not yet realized much of the expected merger savings, so an adjustment to 1998 expense levels was more appropriate. The 1999 data used in Verizon VA's study already reflects some merger savings that should have been realized. Thus, it is inappropriate to assume that Verizon could realize additional merger savings of the same magnitude going forward.[35/] Second, the New York filing also included an approximation for the costs associated with ongoing reorganizations of the workforce. The savings associated with a merger cannot be achieved without expenditures to implement the merger; both therefore would have to be reflected. Third, the planning horizon in these proceedings is three years. In some cases the merger savings were not projected to be realized for several years: as AT&T/WorldCom themselves argue, some merger savings from the Bell Atlantic/NYNEX merger were not anticipated to be achieved until well after 1999, and the same would be true with respect to the GTE merger. In the New York proceeding, no concrete time period was assumed with respect to the planning horizon, and thus that analysis is irrelevant.

Q. Should the Commission accept AT&T/WorldCom's proposed reduction of Verizon's joint and common overhead cost factor to account for merger savings?

A. No. The Commission should not reduce the cost factor. Any productivity gains attributable to mergers are accounted for in Verizon's cost studies already; as to other possible savings from the mergers, AT&T/WorldCom have not made a sufficient showing that these savings apply to Verizon VA.

[35/] Of course, in other cases, merger savings may not even be realized within the relevant planning horizon.

G. VERIZON VA'S NON-RECURRING COST AND OSS ADJUSTMENTS IN THE ACF CALCULATIONS ARE APPROPRIATE

Q. What other adjustments do AT&T/WorldCom propose to Verizon VA's ACF calculations?

A. AT&T/WorldCom propose to back out Verizon VA's subtraction of the non-recurring revenues from Verizon's ACF calculations, and they similarly propose to undo Verizon VA's OSS adjustments. Neither change is appropriate. Verizon VA removes its non-recurring cost revenues to ensure that it does not double recover any non-recurring costs in its recurring rates. AT&T/WorldCom's adjustment to eliminate this removal of the non-recurring revenues is a function of their position that virtually none of Verizon VA's non-recurring costs should be recovered on a non-recurring basis. As explained in detail by the Verizon Panel Direct and the Non-recurring Panel Surrebuttal also submitted today, their position is legally and economically erroneous and is inconsistent with the realities of the services Verizon VA provides to CLECs to meet their service requests.

AT&T/WorldCom's effort to require the recovery of all OSS costs through the ACFs is similarly unsound. It is far more efficient from an economic perspective to drive easily identifiable costs to the UNE to which they relate, rather than to spread those costs over all users indiscriminately. Access to OSS is a UNE, and its costs should be reflected in the rates for that UNE. Those CLECs that make the most use of the Access to OSS UNE should shoulder the cost of that UNE. As a result, Verizon VA backs those costs out of the ACFs.

H. AT&T/WORLDCOM'S PROPOSED REMOVAL OF THE FLC ADJUSTMENT TO VERIZON VA'S L&B FACTORS, COMBINED WITH THEIR FAILURE TO INCLUDE A CC/BC RATIO, IS INDEFENSIBLE

Q. Please describe AT&T/WorldCom's modification to the Land and Building (L&B) factors.

A. Although this point is never specifically addressed in the AT&T/WorldCom Rebuttal Panel's testimony, AT&T/WorldCom, in their "Restatement of VZ Cost Studies," change the development of the L&B factors by removing the application of Verizon's FLC. Interestingly, although elsewhere AT&T/WorldCom insist on the application of the CC/BC ratio to embedded investment (as described above), in this particular case they do not make that adjustment. The reason they fail to do so is obvious. The L&B factor is an investment-to-investment ratio,[36] and the CC/BC for the numerator is higher than the CC/BC ratio for the denominator which means that the L&B factor would be *higher* when the CC/BC is applied. But because this result is not desirable, AT&T/WorldCom choose to be inconsistent and simply omit their

[36] The L&B factor divides the L&B Investment by the related central office equipment investment. For further support, *see* VZ-VA Supplemental Response to AT&T/WorldCom 1-2. (Attachment B.)

proposed CC/BC ratio in order to *reduce* Verizon VA's L&B factor by over 20%.

Q. Should the Commission accept AT&T/WorldCom's removal of the FLC factor from the L&B factor?

A. No. Verizon's application of the FLC factor to the L&B factor is proper and reasonable; AT&T/WorldCom's removal of the FLC factor, combined with the inconsistent decision not to apply a CC/BC ratio to the L&B factor (as they advocate for the ACFs), is not.

I. VERIZON VA'S EF&I FACTORS ARE ACCURATE AND APPROPRIATE FOR USE IN THESE COST STUDIES

Q. Please explain how Verizon VA developed its EF&I factors.

A. Verizon VA used actual data for equipment installed in calendar year 1998 to develop factors based on the material-only investments for each class of equipment.

Q. AT&T/WorldCom state that they asked Verizon VA for the detailed data underlying its EF&I factors as well, but that Verizon VA has not provided them. Is that true?

A. No, it is not. Verizon complied fully with AT&T/WorldCom's requests for EF&I data; the only request for specific EF&I backup related to the

EF&I for digital switches, which Verizon VA provided.[37] Nonetheless, in the spirit of compiling as complete a record as possible, attached to this surrebuttal is a CD that contains the underlying data for all of the accounts for which an EF&I factor has been developed.[38]

Q. AT&T/WorldCom claim that "Verizon has made no attempt to establish that its historical experience is at all reflective of the EF&I costs likely to be needed in a forward-looking environment." [AT&T/WorldCom Rebuttal Panel at 74.] Is this true?

A. No. To establish the forward-looking relationship illustrated by the EF&I factors, Verizon VA used its experience with the most recent types of equipment installations for which the data has been validated (at the time the studies were completed, this was 1998). There is no reason to believe that these costs will vary simply because material investment may be reduced in the forward-looking network. Nor is there any basis to believe that the 1998 costs are likely to change significantly. The technology employed in 1998 has not undergone major changes; nor is it expected to undergo transformation within the planning period. For example, though in AT&T/WorldCom's direct case, much is made about the significant decreases in EF&I expenses that should result from the use of pre-

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[37] *See, e.g.,* VZ-VA Response to AT&T/WorldCom 1-1; VZ-VA Supplemental Response to AT&T/WorldCom 1-1.

[38] 1998 DCPR Data CD, Attachment F.

assembled plant,[39] Verizon VA has been using such pre-assembled plant for over 20 years. Notably, other than making this general criticism, AT&T/WorldCom do not include in their testimony any basis for believing that EF&I expenses will in fact decrease in the forward-looking network — though clearly it is their burden to do so.

It is curious that on the one hand, AT&T/WorldCom would argue that the use of "historical experience" in 1998 may not be reflective of the EF&I costs that would be needed in a forward-looking environment, while at the same time, in their criticism of Verizon VA's digital switch EF&I (which is discussed below in the context of switching costs generally), they would assert that an EF&I factor developed in 1992 (presumably using data from 1990 or 1991) is relevant to the EF&I costs that would be incurred in a forward-looking environment.[40] This incongruity is simply another illustration of AT&T/WorldCom's effort to advocate reduced costs in whatever manner possible, even at the expense of consistency.

Q. AT&T/WorldCom suggest that the investment costs included in Verizon VA's EF&I calculations include removal of older equipment and costs for reconfiguring existing office space to accommodate new equipment; they argue that this means Verizon VA's EF&I factors

39/ *See* Riolo Direct at 19-20.

40/ *See* AT&T/WorldCom Rebuttal Panel at 121.

include costs inherently associated with the embedded network and do not "reflect the forward-looking efficiencies of a new installation in a new building designed specifically for the equipment." Is this criticism accurate? [AT&T/WorldCom Rebuttal Panel at 74-75.]

A. No. The entire premise of this criticism is incorrect. The cost of removal of older equipment is a cost associated with the depreciation expense of the older equipment, not with the EF&I of the newer replacement plant. It is a basic accounting principle that in calculating the depreciation of a piece of equipment, the cost of removal is considered.[41/] Thus, notwithstanding AT&T/WorldCom's confusion on this point,[42/] removal costs simply are not included in the EF&I for new plant. Similarly, reconfiguration expenses are simply not relevant to, or included in, EF&I calculations. If a reconfiguration results in less than a full "retirement unit" being placed (or even full retirement units simply being moved), the cost would be included in the ACF calculations (generally with respect to the Network ACF), not as part of the EF&I for the plant being installed. If

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[41/] The depreciation amount is the first cost of an asset minus the net salvage (spread over the average service life). The net salvage is equal to the gross salvage minus the cost of removal. Thus, the depreciation amount is equal to the first cost, minus the gross salvage, plus the cost of removal. *See* AT&T Construction Plans Department, Engineering Economy: A Manager's Guide to Economic Decision Making 155-56 (3d ed. 1977). (Attachment G.)

[42/] *See* AT&T/WorldCom Response to VA-VA 13-14 ("the cost of removal of the old piece of equipment would be part of the overall cost of the replacement project"). Based on this quote, it appears that AT&T/WorldCom misunderstand the distinction between the budgeting process used to manage a project and the retirement accounting process that Verizon VA utilizes to reflect assets on its books. (Attachment A.)

a full "retirement unit" were removed or installed, the costs would be capitalized as part of that retirement unit — and not included in the EF&I of the other plant being installed. Again, AT&T/WorldCom's analysis reflects their misunderstanding of two distinct sets of accounting rules — the capitalization/expensing of assets, and depreciation accounting.[43/] The Verizon VA EF&I calculations therefore include neither removal costs for old equipment nor reconfiguration costs of buildings and office space.

Q. AT&T/WorldCom criticize Verizon VA for using an EF&I factor for DLC equipment that is calculated based on the combination of both plug-in and hardwire equipment, and instead propose application of the lower plug-in-only factor to DLC plug-in equipment. [AT&T/WorldCom Rebuttal Panel at 75-76.] Is that change appropriate?

A. Such a change could in theory be appropriate, but only if AT&T/WorldCom also imposed the higher "hardwire-equipment-only factor" to all DLC equipment *other than* plug-ins. AT&T/WorldCom are correct that a pure plug-in equipment EF&I would be lower than a

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[43/] *See id.* ("Expenditures are typically capitalized once the expenditure amount exceeds a set amount. All expenditures not meeting this capitalization criteria are expensed."). While expenditures for tangible assets above a certain dollar value will be capitalized, these assets would represent their own distinct units of plant, not a "loading" on the EF&I of another item of plant. Thus, it would be considered part of both the numerator and the denominator in the determination of plant-specific EF&I factors.

combined plug-in/hardwire equipment EF&I because installation of plug-in equipment is relatively simple. Conversely, a hardwire-equipment-only factor would be *higher* than the combined factor. Not surprisingly, while AT&T/WorldCom advocate applying the lower rate to DLC plug-ins, they do not advocate or even mention applying the higher hardwire-only EF&I to all other DLC equipment.

In contrast, Verizon VA's calculation and application of the EF&I factor is entirely consistent. The EF&I costs for plug-in and hardwire equipment are averaged and applied to the total plug-in and hardwire investment. Verizon VA's use of a weighted average produces accurate results that should mirror a *consistent* application of the separate factor approach AT&T/WorldCom suggest; but, as noted above, such a consistent application would not achieve AT&T/WorldCom's goals, and they thus do not propose it.

Q. Should the Commission accept AT&T/WorldCom's reduction of Verizon's EF&I factor?

A. The Commission should not reduce Verizon's EF&I factor. AT&T/WorldCom's position is based on inaccurate or inapplicable data and unreasonable assumptions. Verizon's development of its EF&I factor is far more reasonable.

Q. Does this conclude your testimony concerning Verizon VA's costing methodology?

A. Yes. As we have shown, elimination of the FLC factor would result in the significant understatement of forward-looking investments by applying TELRIC adjustments not once, but twice, as Judge Linsider found in New York. AT&T/WorldCom's arguments concerning the FLC simply misrepresent both its intent and its impact. AT&T/WorldCom's insistence that Verizon VA apply a CC/BC ratio to its embedded investment is simply designed to reduce Verizon VA's ACFs without addressing the inherent mismatch of the ACFs to TELRIC investment that the FLC was designed to remedy. Finally, AT&T/WorldCom's efforts to reduce various costs and expenses consist generally of unsupported arguments that are erroneous, are inconsistent with Verizon VA's overall costing approach, and fall far short of the burden that AT&T/WorldCom must meet to demonstrate why its proposals are reasonable and accurate.

In sum, these and other criticisms raised by AT&T/WorldCom are erroneous and do nothing to detract from Verizon VA's overall costing methodology, which the Commission should credit as entirely reasonable and appropriate.